STANDARD & POOR'S

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University of Guelph

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Rationale

Issuer Credit Rating
A+/Stable/--

The ratings on the University of Guelph, in the Province of Ontario (AA/Stable/A-1+), reflect, in our opinion, the university's strong demand profile, which its firm academic niche and research profile support; healthy provincial support; and sufficient near-term liquidity. Constraining the ratings are balance-sheet weakening and persistent, consolidated operating deficits.

In our opinion, credit strengths include:

- Sufficient near-term liquidity. The uncertainties regarding the university's cash flows have been resolved in the near term. This is largely due to management's strategic decision to make a one-time C$28 million contribution into its defined benefit (DB) pension plan and change its pension filing date in the 2007 valuation year. This substantially lowered Guelph's annual pension contribution to an average of about C$15 million during the next three years from the initially expected C$48 million. Nevertheless, its next pension filing date will be in August 2010. Actuarial valuations and pension asset values then could significantly raise annual contributions. Depending on the severity of the required payments, the university's ability to fund it, and the effect on the balance sheet at that time, this could put downward pressure on the ratings;
- Strong student demand, which an excellent niche and research profile support. Based on application statistics from the Ontario University's Application Centre for fall 2008 admission, as of Sept. 11, 2008, total applications to the university rose 8%, and applications to the Guelph-Humber campus (a partnership the university has with Humber College) by 29%. The system's average increase was 3.4%. Boosting Guelph's demand profile is the university's well-defined niche in veterinary, bioscience, and agriscience-related programs. A major component of the university's research is its multifaceted agrifood initiative that the Ontario Ministry of Agriculture, Farming, and Rural Affairs (OMAFRA) sponsors; and
- Good support from the Province of Ontario (AA/Stable/A-1+), which partially underpins the ratings. Provincial support, including the OMAFRA contract, accounts for about 36% of total revenues. Nevertheless, given the strong likelihood of the province running a deficit in the near term, we expect total Ministry of Training, Colleges and Universities (MTCU) grants to decrease in the next couple of years. However, Standard & Poor's believes that additional OMAFRA funding and Guelph's strategic budgeting initiative should help it through the funding shortfall.

We believe credit concerns include:

- A weakening balance sheet. In fiscal 2008, unrestricted financial resources (internally restricted net assets plus internally restricted endowments) were about 33% of total debt. Guelph's debt was C$9,162 per full-time equivalent (FTE), or 31% of adjusted revenue. Although these metrics have weakened, they are consistent with the rating. We expect further moderate weakening debt ratios, given Guelph's plans to issue about C$37 million in the next three years; and
- Persistent annual consolidated operating deficits. In fiscal 2008, Guelph's consolidated deficit was 2% of total revenues. However, adjusted for noncash items (deferred capital revenue and depreciation), the university had a surplus of just more than 1%. Accounting for 61% of total expenses, compensation (salary and benefits) remains

the university's greatest pressure. Although Guelph has posted annual operating deficits (on a consolidated basis) in the past five years, it is implementing several restructuring initiatives (including a buyout program) to achieve medium-term savings.

Outlook

The stable outlook reflects the university's management resolving its cash-flow uncertainties for the near term. The outlook also reflects our expectation that Guelph's liquidity will remain sufficient, and its balance sheet will not further weaken. It also reflects our expectation that Guelph would successfully manage through a period of potentially lower provincial grants and asset values (both endowment and pension) without deteriorating its operations. Not meeting some of these expectations could prompt a downgrade. Substantially improved unfunded postemployment liabilities, significantly lower debt, or a rise in unrestricted financial resources, could lead to a positive rating action.

Graduate Enrolment Rises

In fiscal 2008, Guelph's enrolment was 18,300 FTEs, essentially unchanged from the previous year. This is largely because the university's graduate enrolment increased by about 255 FTEs, while its undergraduate enrolment decreased by slightly less. This is consistent with the university's enrolment target of 18,000, which it strategically determined as the number of students the university's campus infrastructure (including residences) and current program delivery assumptions could accommodate. Accompanying a provincial initiative to increase graduate spaces, and fully funding them, Guelph plans to raise graduate enrolment by about 330 FTEs from fiscal 2004 levels. By fiscal 2008, despite the fierce competition and unlike most of its peers, the university exceeded its enrolment target for masters programs. However, it fell short of its target for doctoral programs.

Operating shortfall raises accumulated net asset deficit

Guelph's operating challenges remain a concern for Standard & Poor's. In fiscal 2008, its consolidated deficit was 2% of total revenues. However, adjusted for noncash items (deferred capital revenue and depreciation), the university had a surplus of just more than 1%. Accounting for 61% of total expenses, compensation (salary and benefits) remains the university's greatest pressure. Salary expense increases averaged 5% in the past five years and 6.5% in fiscal 2008. The 2008 rise largely reflects negotiated salary increases and additional hiring for graduate enrolment growth. The benefits expense decreased 8.3% to C$75 million, primarily the result of major cash contributions related to Guleph's pension expense.

Operating and policy support from the province is good, and in part underpin the ratings. MTCU operating grants account for about 27% of Guelph's total revenues. Nevertheless, overall provincial funding decreased by about 4% in fiscal 2008, following a major one-time grant (of C$12.7 million) the previous year. Given the strong likelihood of the province running a deficit in the near term, we expect total MTCU grants to further decrease in the next couple of years (Guelph projects a 2% reduction in fiscal 2009).

Even so, the university's unique agricultural grounding and curriculum provide it with additional funds from OMAFRA, which make up about 15% of total revenue. Standard & Poor's does not expect funding from its contract with OMAFRA to decrease in the near term. Rather, the opposite, due to Guelph signing a five-year funding agreement in fiscal 2008 with it, increasing annual funding by C$21 million to C$76 million per year.

Although the funding impact will not be fully reflected until fiscal 2009, as part of the funding, Guelph received one-time payment of C$56 million in fiscal 2008. Although the OMAFRA funding is restricted, it is part of the university's total operating budget and helps fund 90 faculty FTEs, 470 full-time staff, and operating and infrastructure costs.

Furthermore, through its initiative to raise graduate enrolment by 14,000 systemwide, the province is committing up to C$220 million per year on the operations side and C$550 million for capital to support the graduate spaces. By fiscal 2008, the university exceeded its enrolment target for masters programs, unlike most of its peers, but fell short for doctoral programs. Guelph's share of the graduate operating funding is about C$5 million, which helps with teaching and student support expenses for the additional spaces.

Also supporting operations is the province's tuition policy (tuition revenue generally accounts for more than 17% of total revenues), which gives universities some tuition-setting flexibility. Provincial policy allows universities to increase tuition by a maximum annual average of 5% institutionwide, which Guelph's increases essentially mirror. There is some uncertainty regarding future tuition policy, as the current framework is in place only until fiscal 2010. Nevertheless, we believe that the province is unlikely to freeze tuition, and that there will continue to be some form of limited flexibility.

Guelph's joint venture with Humber College Institute of Technology and Advanced Learning is earning the university net revenues: C$4.4 million in fiscal 2008. Generally however, the university's expenses are rising faster than revenues; it has posted annual operating deficits (on a consolidated basis) in the past five years. These have added up. Guelph's accumulated net asset deficit was C$102 million, growing by more than 50% in fiscal 2008 alone. Virtually all the deficit is related to the university's accrued employee future benefits costs (which are noncash expenses). To achieve medium-term structural cost reductions, the deficit should increase in the near term due to restructuring costs (mainly for a buyout) of about C$20 million in fiscal 2009. This is part of Guelph's integrated planning process, which was initiated in fiscal 2006. Guelph has successfully implemented and recouped savings from buyout programs in the recent past.

Capital Program To Focus On Veterinary College And Critical Maintenance

In the next five years, most of the capital will be for expanding and redeveloping the university's Ontario Veterinary College (OVC). The first phase is a redevelopment estimated at C$78 million, C$25 million of which the province has contributed. It also includes a pathobiology building for C$37 million, for which the federal government has flowed funds.

The second phase, for primary care, is estimated at C$14.5 million, C$9.5 million from the province and C$5.0 million from the private sector. Construction on the project began in 2008 and should be complete by 2011.

For both phases, a total of $6 million is related to the university's five-year capital renewal program. The university has estimated C$300 million in deferred capital maintenance (C$200 million for campus buildings, C$40 million for repair of residences, and C$45 million for utilities infrastructure), which is very high relative to that of its peers. To at least hold that figure steady, the university has embarked on a five-year (2007-2011) capital renewal financing plan. The plan requires C$119 million in project renewals, about C$78 million is for campus facilities, and C$41 million for student housing. Debt financing of about $57 million would be required, lower than the board-approved C$65 million, and the C$91 million estimated in fiscal 2007.

Guelph's largest planned project is the OVC Health Sciences Centre (which would include hospitals, related research and a Zooneses center), estimated at more than $250 million. Although the university is looking into various financing arrangements for the project, a large portion would likely be provincially funded. Standard & Poor's will monitor the project's progress and financing as details emerge.

Moderately Rising Debt

In fiscal 2008, Guelph had C$167.7 million in debt, or C$9,162 per FTE and 31% of adjusted revenue. The university's debt service coverage was 1.5x, and its unrestricted financial resources were 33% of debt. Although these metrics are low compared with those of its higher rated Canadian peers, they are consistent with the ratings. Furthermore, these metrics have improved since fiscal 2005.

The majority of Guelph's debt consists of the C$100 million in senior unsecured bullet maturity debentures, issued in 2002 and maturing in 2042. The debenture financed major academic buildings (C$86 million was for Rozanski Hall, the McKinnon extension, and the Science Complex; C$14 million was for Guelph's deferred maintenance). Guelph has established an internal sinking fund to provide for debt retirement, although it is not required by covenant to do so. As of fiscal 2008, Guelph contributed C$16.4 million to the fund, C$3.4 million of which will be reinvested for the purpose of retiring the C$100.0 million debenture. Approximately 34% (C$57 million) of Guelph's total debt consists of leases, mortgages, and loans for student housing, which covers 5,000 beds across campus.

As part of the C$57 million debt financing requirements for its critical deferred maintenance and capital renewal, Guelph issued C$11 million in 2008, which was partially offset by a C$2.6 million debt repayment. The remaining debt financing would be spread out in three years, which should make the debt more manageable, and reduce some of the debt carrying costs. In that time, although Guelph's debt measures should remain consistent with the rating they would likely weaken. The university's debt service coverage ratio could drop to 1.4x, and debt rise to 37% of adjusted revenue. Guelph's unrestricted financial resources could also further weaken to about 27% of total debt.

The university has entered into various interest-rate swap agreements, accounting for about 28% of total debt with equally or higher rated counterparties. These include Bank of Montreal (A+/Stable/A-1+), Toronto Dominion Bank (AA-/Stable/A-1+), and Canadian Imperial Bank of Commerce (A+/Negative/A-1). The swap agreements synthetically fix the university's variable-rate debt.

Pension Deficit Increases Significantly

Largely due to pension asset losses from poor market performance, Guelph's unfunded DB pension liability increased by about 70% to C$122 million in fiscal 2008. Guelph also had unfunded nonpension benefit plan (such as medical, dental and drug plans) liabilities totaling C$250 million. Even when compared to peers with DB plans, such as McMaster University (AA/Stable/--), these are very significant for an institution of Guelph's size. Given the severe market volatility, Standard & Poor's is not taking any immediate rating actions. However, a prolonged suppressed value of market assets (which includes endowment assets) could potentially lead to a downgrade, all else remaining the same.

Guelph's total liabilities (debt plus unfunded postemployment liabilities) were about 95% of total revenue at fiscal year-end 2008. This significantly exceeds that of any of Guelph's rated peers, and could increase to more than 100%

when the university proceeds with its planned debt issuance.

Endowment Takes A Hit

The market value of Guelph's endowment was C$172 million, or C$9,395 per FTE, in fiscal 2008. Similar to those of its peers, the university's endowment value dropped 7% from the previous year due to poor market performance. But it has likely dropped considerably further since then. Also reflected in the decrease are funds disbursed for spending from previous years' capital appreciation, net of fiscal 2008 additions. The annual spending rate of the general endowment, which accounts for 68% of total endowments and goes mostly toward student assistance, is 4.5% of the four-year average endowment balance. In accordance with the spending policy, C$7 million of the total accumulated investment earnings were available for disbursement. To account for the investment losses, and ensure capital protection, the university is considering temporarily suspending the payouts.

The portion of endowments that contribute to the university's balance-sheet flexibility or internally restricted funds is about C$18.4 million on a book-value basis. The university also had about C$37.4 million in internally restricted net assets, bringing its total internally restricted resources (internally restricted endowments plus internal funds) to about C$56 million. This is about C$3,049 per FTE, considerably lower than the C$4,173 reported in 2006, and the lowest of its rated peers.

About 88% of Guelph's endowments have external restrictions. But even these funds provide strength, in our opinion, through producing spendable endowment income and freeing up other operating funds.

Cash Flow Uncertainties Subdued

Standard & Poor's had previously revised the outlook on Guelph to negative Nov. 8, 2007. This was primarily due to cash-flow challenges, as Guelph was expecting to make C$48 million annual solvency-based contributions to its DB pension plan. There was a possibility that the university could have negative cash balances sometime during the course of fiscals 2008 and 2009. These concerns did not materialize for a few reasons. First, the university changed its pension filling date in 2007 from Sept. 30 to Aug. 1. Solvency-based payments are determined by the availability of the university's funds to meet all accumulated pension obligations at specified valuation filing dates. Financial conditions at the time of valuation significantly influence contribution amounts. Because financial volatility did not begin to set in until about mid-August 2007, changing the filing date to Aug. 1 locked-in higher pension asset values and prevented larger contributions (from lower pension asset market values) stemming from a Sept. 30 filing date. Also, to stabilize university contributions until August 2010, the university made a C$28 million contribution, based on the Aug. 1 valuation date and as part of a formal filing to provincial authorities. This payment lowers the university's annual pension contribution to a manageable average of about C$15 million in the next three years. Standard & Poor's recognizes that there is a risk of contributions substantially increasing beyond 2010, as a result of lower pension-asset market valuations at that time. We will continue to closely monitor this situation.

Further subduing Guelph's liquidity challenges are its lines of credit totaling C$10 million with various banks. Also, as part of its revised multiyear agreement with OMAFRA, the university received a one-time cash payment of C$56 million.

Solid Research Profile

Guelph came in second in a comprehensive survey published by Research Infosource Inc. Nov. 7, 2008, that ranks all Canadian universities on sponsored research income and research funding per full-time faculty. A major component of Guelph's research is its multifaceted agrifood initiative that OMAFRA sponsors. In addition to accounting for about 28% of Guelph's research funding, the OMAFRA contract gives the university a strong niche among the province's 19 universities. In fiscal 2008, Guelph received C$138 million in research funding, about 7% greater than in fiscal 2007.

University of Guelph--Peer Comparison

	University of Guelph		York University		McMaster University
Thou. C$ (except FTE and ratios)	2008	2007	2008	2007	2007
Issuer credit rating	A+/Stable/--	A+/Negative/--	AA-/Stable	AA-/Stable	AA/Stable/--
Applicants	23,448	22,219	58,378	54,258	40849
Offers	14,107	13,487	43,730	40,820	23881
Registrants	4,478	4,359	N.A.	N.A.	5281
Acceptance rate (offers/applicants; %)	60	61	75	75	58
Yield (registrants/applicants; %)	19	20	N.A	N.A.	13
FTEs	18,298	18,286	44,824	45,611	22,903
Total revenue	569,267	560,491	848,824	824,481	730,966
Deferred capital	21,644	20,901	12,410	10,384	38,268
Adjusted revenue	547,623	539,590	836,414	814,097	692,698
Total expenditure	581,441	563,391	847,099	783,901	707,304
Interest	12,166	10,635	22,997	23,314	11,145
Depreciation	39,889	39,378	37,905	38,315	62,430
Adjusted expenditure (For DSCR)	529,386	513,378	786,197	722,272	633,729
Consolidated surplus (%)	(2.1)	(0.5)	0.2	4.9	3.2
Consolidated surplus (for calculating DSCR; %)	1.1	2.9	3.3	8.4	6.9
DSCR (interest only; x)	1.50	2.46	2.18	3.94	5.29
Total debt	167,654	159,307	347,122	352,716	156,265
Unfunded post-employment liabilities	371,556	308,395	123,196	$137,270	322,141
Interest expense to adjusted revenue	2.2	2.0	2.7	2.9	1.6
Debt to FTE	9,162	8,712	7,744	7,733	6,822.9
Debt to adjusted revenue (%)	30.6	29.5	41.5	43.3	22.6
(Debt plus unfunded)/adjusted revenue (%)	98.5	86.7	56.2	60.2	69.1
Internally restricted net assets	37,361	37,406	152,019	172,699	66,110
Internally restricted endowments	18,425	21,149	45,167	44,053	154,823
Externally restricted endowments	139,653	152,118	220,612	201,394	343,700
Unrestricted financial resources	55,786	58,555	197,186	216,752	220,933
As % of total debt	33.3	36.8	56.8	61.5	141.4
As % of total debt plus unfunded post-employment liabilities	10.3	12.5	41.9	44.2	46.2
As a % of operating Expense	9.6	10.4	23.3	27.7	31.2
Per FTE	3,049	3,202	4,399	4,752	9,646

University of Guelph--Peer Comparison (cont.)					
Total endowment value per FTE (at market value)	9,394	10,112	6,804	6,687	21,766

FTE--Full-time equivalent. DSCR--Debt service coverage ratio. N.A.--Not available.

Ratings Detail (As Of December 8, 2008)*	
University of Guelph	
Issuer Credit Rating	A+/Stable/--
Senior Unsecured (1 Issue)	A+
Issuer Credit Ratings History	
28-Nov-2008	A+/Stable/--
08-Nov-2007	A+/Negative/--
25-Oct-2006	A+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.